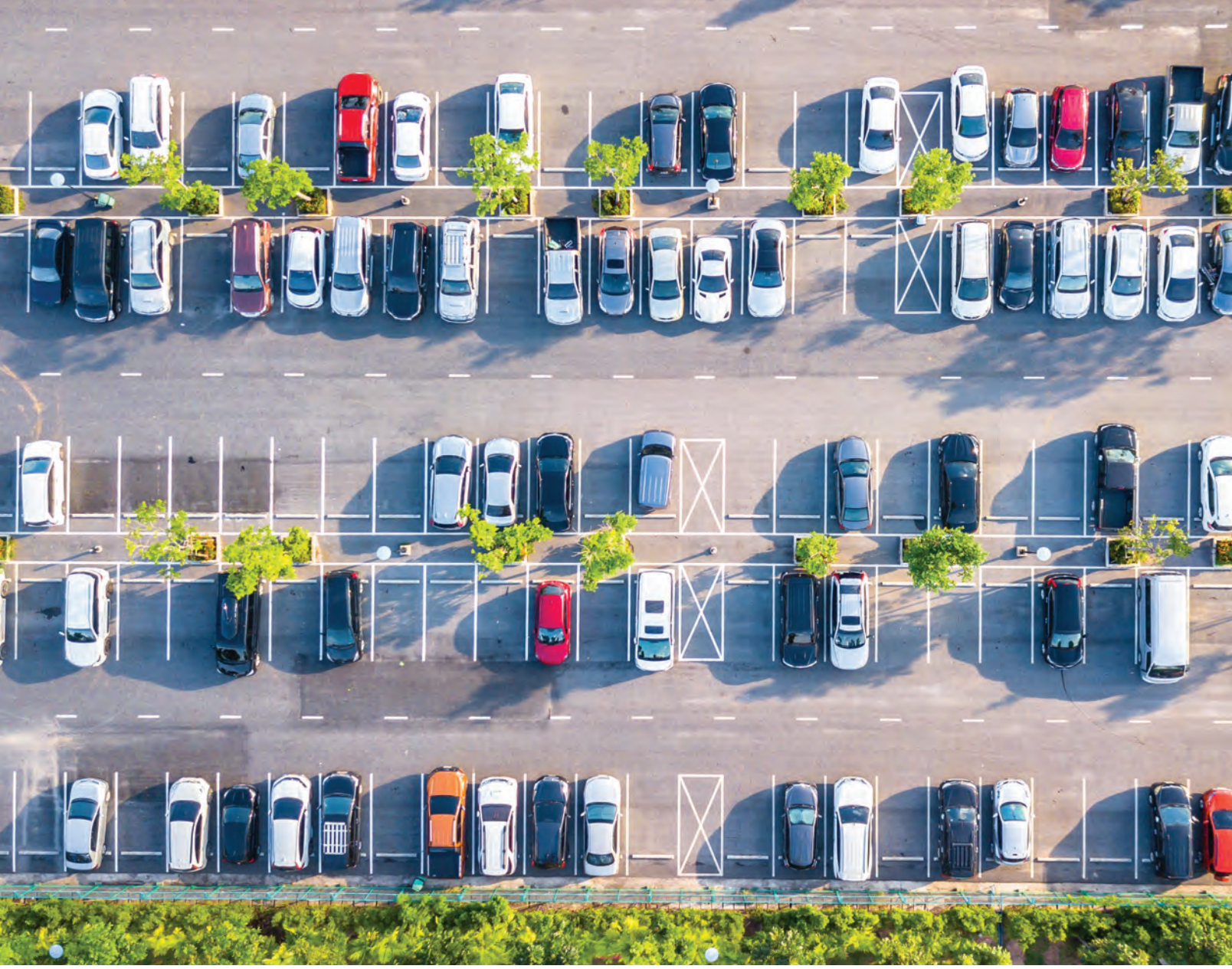


VALUE BUILDINGS IF THEY'RE NOT BEING TAKEN?

Shedding light on complicated valuations

BY CHRIS PETERSON, STEPHEN ROACH AND ERIC SCHNEIDER

Imagine an agency client has called you to appraise a neighborhood shopping center on a busy thoroughfare. The reason for the appraisal is that a portion of the property is being acquired for a road-widening project and as part of the project, they are taking a temporary construction easement (TCE) on a portion of the parking lot for equipment storage. None of the shopping center improvements are being touched and the client, who is sensitive to both timing and fee, is asking for an appraisal of only the land since that is what is being affected.

An acquisition of only the land on an improved property is a fairly common appraisal scenario in right of way acquisitions. On the surface, it can appear to be a straightforward assignment. But what happens when the assignment is not straightforward, and the acquisition ends up substantially impacting not only the area directly impacted, but the shopping center as well?

Valuing Only the Land

One of the first questions to ask is whether an appraiser can value only the land, even though the property is improved. To answer that question, we look to an appraiser's professional standards, specifically the Uniform Standards of Professional Appraisal Practice. A frequently asked question in USPAP discusses whether an appraisal of only the land under a shopping center can comply with USPAP.

The answer is yes. This type of assignment is certainly one that an appraiser can perform. However, to achieve credible assignment results, the appraiser must identify the characteristics of the property that are relevant to the type and definition of value, as well as the intended use of the appraisal. These types of characteristics include whether the subject property is only a physical segment of the property, such as land. Further, an appraiser is not required to value the whole when the subject of the appraisal is determined to be a partial interest.

Is it Credible?

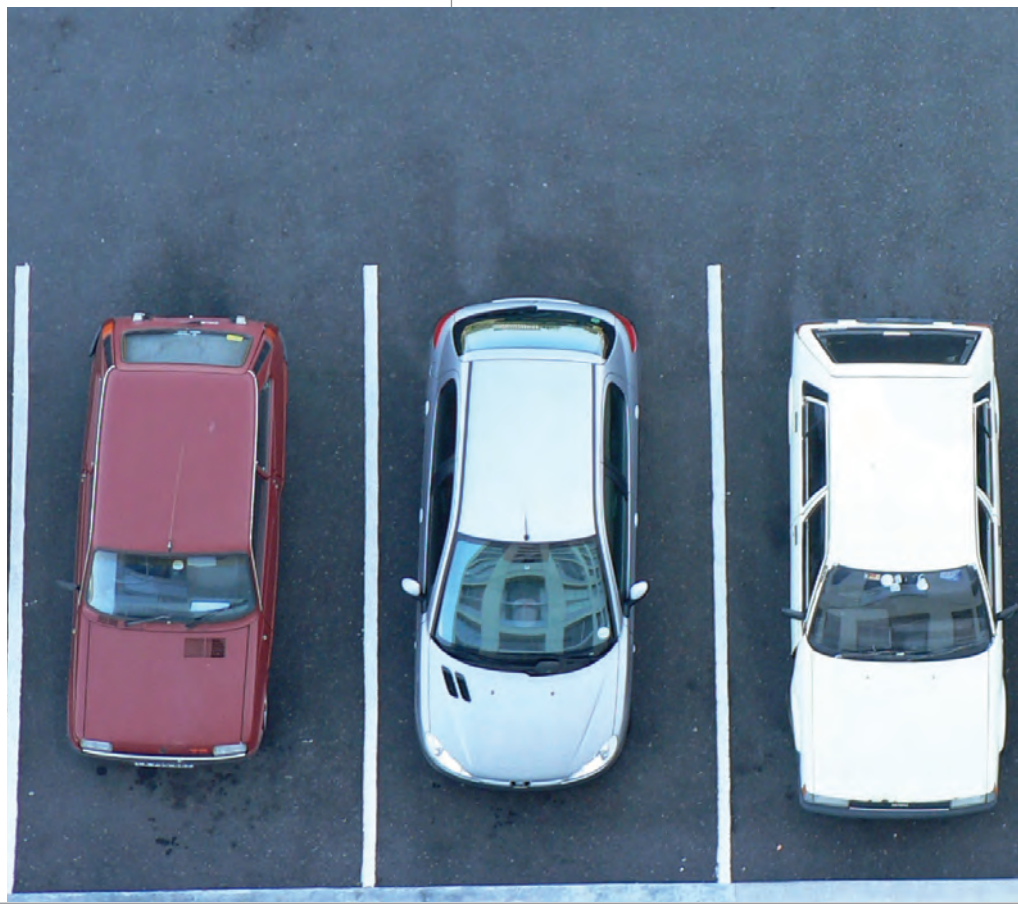
The next question becomes whether valuing only the land of an improved property provides credible assignment results. This question is a little more complicated because the answer involves looking beyond a particular assignment. However, like with the previous question, the answer starts with USPAP.

USPAP contains the Scope of Work Rule and in this rule, there are three tasks that an appraiser must perform for each appraisal assignment. These include 1) identifying the problem to be solved, 2) determining and performing the scope of work necessary to develop credible assignment results and 3) disclosing the scope of work in the report.

With respect to identifying the appraisal problem, certain "assignment elements" need to be addressed to assist with the scope of work determination. Of particular note is the intended use of the appraiser's opinions and conclusions, as well as the subject of the assignment and its relevant characteristics. Both of these elements are needed to assist in determining the type and extent of the research and analysis to perform.

The other component to consider is what constitutes an acceptable scope of work. USPAP provides some guidance on this, stating that the scope of work is acceptable when it meets or exceeds the expectations of regular intended users for similar assignments and the actions of an appraiser's peers when performing the same or similar assignment.

To put this into context, the appraisal problem in the right of way arena generally involves valuing a property to assist in determining just compensation related to the acquisition. If the assignment is, like our example, a TCE in the parking lot of a shopping center, the "relevant characteristics" could include only researching and analyzing information related to the land. Furthermore, the typical agency may expect only



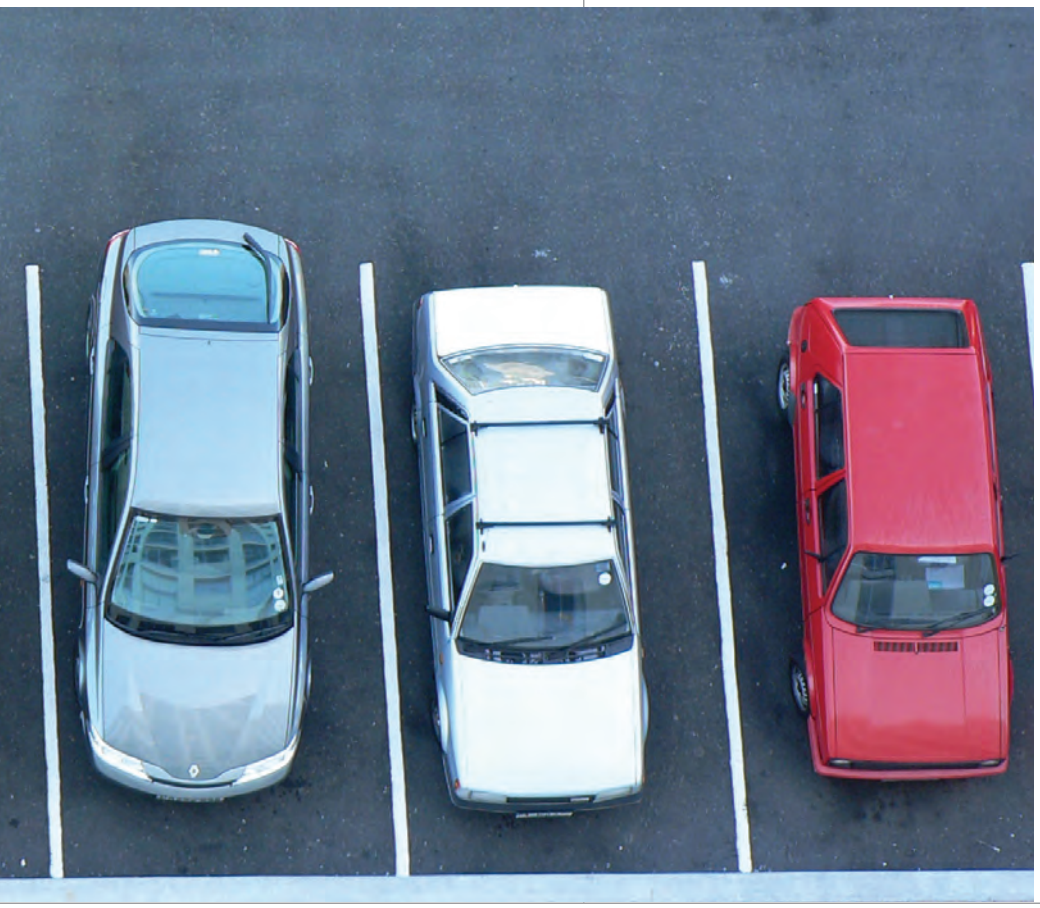
a valuation of the land and other appraisers who specialize in right of way may perform the same land-only analysis.

Is it Appropriate?

Everything discussed thus far seems to be straightforward. If only the land is being affected and if both clients and appraiser colleagues would consider the land only, then it seems that a valuation of the land satisfies an acceptable scope of work and could lead to credible results. However, there are times when the valuation of the property as improved is critical, both analytically and procedurally. After all, how does the appraiser know that the improvements are not damaged by the acquisition if they are not appraised? Attorneys often argue that the relevant property (the larger parcel) was not actually appraised if only the land is analyzed and valued. In addition, damages to a remainder are typically determined by subtracting the value of the remainder after the taking from the value of the remainder as part of the whole; if neither of those analyses were performed for an improved property, an argument can be made that the appraiser has no basis for a conclusion that the remainder is not adversely impacted by the acquisition and the project.

An Evidentiary Perspective

In eminent domain proceedings, lawyers, judges and the jury scrutinize the sales used by appraisers to value the property acquired. For this article, this litigation process will be analyzed within the framework of California law, but the same general premise applies regardless of the jurisdiction.



The use of a sales comparison approach for an improved property in California is guided by Evidence Code section 816. This code section explains how comparable sales in the marketplace are comparable to the subject to be valued. According to the Evidence Code section 816:

> In order to be considered comparable, the sale or contract … must be sufficiently alike in respect to character, size, situation, usability, and improvements, to make it clear that the property sold and the property being valued are comparable in value and that the price realized for the property sold may fairly be considered as shedding light on the value of the property being valued.

The obvious question this section poses is: if the subject is improved, how can a sale be comparable if the sale is not improved? Notice that the code section does not distinguish between a part-take and a full-take. The code section very clearly and very directly instructs appraisers on how "comparability" is determined in eminent domain proceedings. To dive a bit deeper into the question posed, consider California Civil Jury Instruction number 3506:

> In determining the fair market value of the property you must consider both the value of the land and whether any buildings, machinery, or other equipment attached to the property increase or decrease the value of the property.

This instructs the jury that it *must* consider how an improvement, such as a building, contributes to the subject's valuation. How can a jury do so if the comparables used by an appraiser are vacant, but the subject is improved? Isn't a parcel of dirt completely different than a shopping center?

> If an improved property is valued using a land sale, does that land sale truly shed light on the value of the subject that is to be acquired...?

A Closer Looks at Part-Takes

A major component of just compensation in many part-take acquisitions in eminent domain comes from establishing "severance damages." These damages reflect that the functional utility and other characteristics of the remainder may have been impacted by a part-take; they are the diminution in the value of the property that remains after the acquisition. When the acquisition of property is only a portion of a "larger parcel," compensation *must* include the difference in the fair market value of property in its "before" condition and the fair market value of the remaining portion thereof after the construction of the improvement on the portion taken.

A part-take can and likely will affect an improved property much different than a frontage acquisition of a vacant lot lacking entitlements to develop. A part-take on an improved property supporting a business may drastically impact parking, access, circulation and/or business operations. If an improved property is valued using a land sale, does that land sale truly "shed light" on the value of the subject that is to be acquired as the law has instructed?

On the other hand, if a part-take does not affect an improvement or does not negatively impact a business, then that part-take may only impact land. But then why wouldn't a land sale accomplish the valuation required for such a part-take? It is possible that a frontage take of a vacant lot is analogous to a frontage take impacting a parcel improved with an office building if the acquisition does not impact parking, access, circulation or other functional attributes of the property. To value only land acquired, the appraiser can use only sales of land to determine a land value.

Why does all this legal stuff matter? If a judge determines that a sale does not "shed light" on the value of the property to be acquired, or more specifically, that a land sale does not "shed light" on a part-take of an improved parcel, a jury would not be able to use that land sale in determining the value of the acquisition. Equally as important is that the failure of valuing the property as improved may mask severance damages that would have been established with a valuation of the property as improved.

What's the Risk?

According to California law, an agency may not commence an eminent domain proceeding until its governing body has adopted a resolution of necessity that meets certain criteria. One of the requirements is that the agency must establish an amount that it believes to be just compensation and offer the property owner no less than the amount of its approved appraisal. Therefore, if a court determines that the appraisal was sufficiently flawed and that it could not possibly represent a reasonable estimate of probable compensation, the court could decide that since no code-compliant offer was made, the adoption of the resolution of necessity was improper. This means that the complaint was also improper.

By way of example, one of the authors was retained to review a deposit appraisal involving a commercial property in Southern California. The analysis included only a valuation of the land and therefore ignored the possibility of damages resulting from a significant loss of parking during a protracted construction period, a permanent loss of parking, the creation of an on-site circulation problem and other material issues. When the public agency requested an order for possession, these issues were raised and the court denied the agency's motion for possession to begin construction of the project. Having committed to a construction timeline and having entered into agreements with the construction contractor that required possession of the project right of way by a certain date, the agency had no choice but to make a significantly enhanced offer to the property owner to settle the matter.

The improvements should have been considered and valued in the deposit appraisal. The appraiser's failure to do so resulted in a significant problem for the agency. This is not

an isolated incident either, as we are also aware of a matter where a court negated the resolution of necessity on similar grounds, requiring the agency to start the entire process over to acquire the property. Neither of the appraisers who performed these deposit appraisals did their clients any favors. Both had determined to use a scope of work that ultimately created significant problems and costs for their agency clients.

Conclusion

In determining what is to be appraised, the valuation of only the land *may be* acceptable under professional standards as long as the relevant subject characteristics are properly identified and disclosed. This would include disclosure of the existence of the improvements, whether or not the property as improved is valued, in order for the report to not be misleading.

Professional standards also dictate that the scope of work must be sufficient to develop credible assignment results in the context of the intended use. The determination of the scope of work is ultimately the decision of the appraiser (not the decision of the client as subtlety mentioned in our shopping center example). The appraiser must be prepared to demonstrate that the scope of work is sufficient to produce credible assignment results. Depending on the nature of the taking, the valuation of the land only may be sufficient. However, often a valuation as improved is needed, even if there is no direct acquisition of the improvements.

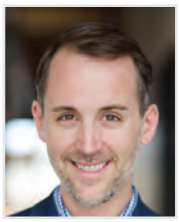
It is also important to know what intended users expect and what an appraiser's peers are doing. In some cases, it may be that an appraisal of the land only could be what is expected for an agency. Additionally, an appraiser (and his or her peers) can decide that it is acceptable to value just the land portion of an improved property for a deposit appraisal. However, what if the appraisal will be used for trial purposes? This is a far less common scenario.

In our experience, trial attorneys expect a valuation of the property as improved, and an analysis of the property as improved is generally performed by appraisers during the trial phase. This is not to say that an appraiser must never appraise an improved property as vacant or never appraise only the land for trial. However, if a valuation as improved is expected by intended users and is commonly done by an appraiser's peers, then that should be done pursuant to an acceptable scope of work.

USPAP warns that an appraiser "must not allow assignment conditions to limit the scope of work to such a degree that the assignment results are not credible in the context of the intended use." The appraiser must fully identify the appraisal problem, conduct all the necessary research and analysis, and disclose what is necessary in the report. If the appraisal is performed properly in the context of professional standards, the appraiser becomes a valuable component of ensuring the property owner's just compensation, whether the appraiser is retained by the agency or the owner's counsel. Either way, an appraiser who is excluded from testifying because he or she didn't value the improvements puts their client at great risk. ✪

Attorney Chris Peterson of Peterson Law Group Professional Corporation focuses on Eminent Domain, Inverse Condemnation, Government tort liability, Dangerous Conditions, Landslides & Debris Flows and some personal injury cases. He has helped his clients achieve excellent results both by settlement and by jury verdicts. He was recently nominated for the American Bar Association's 2019 "On the Rise Top 40 Young Lawyers" award, a national recognition.

Stephen Roach, MAI, SRA, AI-GRS has been an appraiser for over 40 years. Since 1986, he has been co-owner of Jones, Roach, & Caringella, Inc., a real estate valuation and consulting firm based in San Diego. His appraisal assignments have included numerous partial acquisitions and other significant and complex assignments throughout the United States. He also has extensive deposition and trial testimony experience.



Eric Schneider, MAI, SRA, AI-GRS is a Senior Appraiser with Jones, Roach, & Caringella, Inc., a real estate valuation and consulting firm based in San Diego. He has over 10 years of experience in real estate valuation. He currently serves as president of IRWA Chapter 11 and was recently awarded the Chapter's Young Professional of the Year.